

AMENDED IN ASSEMBLY JUNE 2, 2003
AMENDED IN ASSEMBLY MAY 20, 2003
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CALIFORNIA LEGISLATURE—2003–04 REGULAR SESSION

ASSEMBLY BILL

No. 263

**Introduced by Assembly Member Oropeza
(Coauthors: Assembly Members Firebaugh, Strickland, and
Wyland)**

February 4, 2003

An act to repeal and add Section 24410 of the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

AB 263, as amended, Oropeza. Bank and corporation taxes: deduction: insurance company dividends.

The Bank and Corporation Tax Law allows various deductions in computing the income that is subject to the taxes imposed by that law, including a deduction for dividends received by a corporation, commercially domiciled in California, from an insurance company that is subject to insurance tax. Existing law provides that a corporation may only deduct dividends that were paid from the insurance company's California source income. The amount of the dividends eligible for a deduction is further limited and is determined by multiplying the total amount of the dividends by an apportionment factor, equal to the ratio of gross income from California sources to all gross income of the insurance company paying the dividends.

This bill would instead allow a corporation, whether or not engaged in business in California, to take a deduction for ~~95%~~ 80% of the amount of the dividend received from an insurance company, if at the time of the payment the corporation owned at least 80% of each class of stock of the insurance company. This bill would also allow a taxpayer, as defined, a dividend received deduction with respect to certain open years in the amount equal to 90% of the dividends received, if at the time of each dividend payment the taxpayer owned at least 80% of each class of the stock of the insurer and the taxpayer timely files a return expressly electing to be subject to certain specified requirements.

This bill would make legislative findings and declarations in connection thereto.

This bill would also require the Franchise Tax Board to report to the Legislature by a certain date regarding the amount of tax collected pursuant to dividend-received deduction election, as provided by this bill.

This bill would disallow a deduction for 95% of the amount of the dividends received from an insurance company by a taxpayer, as defined, effective for taxable years beginning on or after January 1, 2003, if by a certain date the amount of tax collected by the Franchise Tax Board pursuant to the dividend-received deduction election is less than \$15 million.

This bill would take effect immediately as a tax levy.

Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

The people of the State of California do enact as follows:

- 1 SECTION 1. Section 24410 of the Revenue and Taxation
- 2 Code is repealed.
- 3 SEC. 2. Section 24410 is added to the Revenue and Taxation
- 4 Code, to read:
- 5 24410. (a) For taxable years commencing on or after January
- 6 1, 2003, ~~95~~ 80 percent of the amount of dividends received by a
- 7 corporation during the taxable year from a corporation that is an
- 8 insurer within the meaning of Section 28 of Article XIII of the
- 9 California Constitution, whether or not the insurer is engaged in
- 10 business in California, if at the time of each dividend payment at
- 11 least 80 percent of each class of the stock of the insurer were



1 owned, directly or indirectly, by the corporation receiving the
2 dividend.

3 (b) (1) For all taxable years ending on or after December 1,
4 1997, and commencing before January 1, 2003, a taxpayer may
5 elect to determine its deduction under this section for dividends
6 received during each taxable year from a corporation that is an
7 insurer within the meaning of Section 28 of Article XIII of the
8 California Constitution, whether or not the insurer is engaged in
9 business in California, in an amount equal to 90 percent of the
10 dividends received, if at the time of each dividend payment at least
11 80 percent of each class of stock of the insurer was owned, directly
12 or indirectly, by the corporation receiving the dividend.

13 (2) A taxpayer shall make the election under this subdivision
14 by timely filing a return for at least one taxable year ending on or
15 after December 1, 1997, and commencing before January 1, 2003,
16 expressly electing to be subject to the dividends received
17 deduction in accordance with the percentage set forth in paragraph
18 (1), and reporting and remitting any amounts due pursuant to that
19 election.

20 (3) A return is timely filed for purposes of paragraph (2) if it is
21 filed within 180 days of the effective date of this act.

22 (4) By making the election pursuant to this subdivision, the
23 taxpayer agrees to all of the following:

24 (A) To be subject to the dividends received deduction in
25 accordance with the percentage set forth in paragraph (1) for all
26 taxable years ending on or after December 1, 1997, and
27 commencing before January 1, 2003, for which the Franchise Tax
28 Board may propose an assessment or allow a claim for refund, or
29 in which the final determination of tax for the taxable year has not
30 been made because of a dispute related to the dividends received
31 deduction or the application of Section 24425 to any expense
32 related to that dividends received deduction.

33 (B) (i) Except as provided in clause (ii), to file a return (or
34 amended return) and remit any amounts due pursuant to the
35 election for all taxable years ending on or after December 1, 1997,
36 and commencing before January 1, 2003, for which the Franchise
37 Tax Board may propose an assessment or allow a claim for refund,
38 within 180 days of the effective date of this act.

39 (ii) In the case of a taxable year for which the due date of the
40 return is more than 180 days after the effective date of this act, to

1 file the return and remit any amounts due pursuant to the election
2 under this subdivision on or before the due date of the return.

3 (C) Agrees that, for purposes of this subdivision, the dividends
4 constitute business income and are deductible only in the
5 percentage set forth in paragraph (1) of this subdivision.

6 (5) For purposes of determining taxable income on the
7 amended returns filed pursuant to the election set forth in
8 paragraph (1), Section 24425 does not apply to the amount of the
9 dividends received deduction.

10 (6) The election is irrevocable.

11 SEC. 3. (a) The Legislature finds and declares that the
12 amendments made by this act to Section 24410 of the Revenue and
13 Taxation Code serve a public purpose and are necessary to provide
14 for the equitable tax treatment of insurance company dividends in
15 light of the following circumstances:

16 (1) The California Court of Appeal in a final decision in the
17 case of *Ceridian Corp. v. Franchise Tax Board* (2000) 85
18 Cal.App.4th 875 held that provisions of Section 24410 of the
19 Revenue and Taxation Code that limited a deduction with respect
20 to dividends received from subsidiaries engaged in the insurance
21 business to corporations “commercially domiciled” in California,
22 and to insurance company dividends paid from “income from
23 California sources,” violated the commerce clause of the United
24 States Constitution.

25 (2) In general, insurance companies are not subject to the
26 Corporation Tax Law and cannot be included in the combined
27 report used to determine the California income of related
28 corporations that are subject to the Corporation Tax Law.
29 Consequently, dividends that are paid by insurance companies do
30 not qualify for a deduction under Section 24402 of the Revenue
31 and Taxation Code and are not eligible for elimination from
32 income as provided for in Section 25106 of the Revenue and
33 Taxation Code.

34 (3) In light of the uncertainty following the decision in *Ceridian*
35 *Corp. v. Franchise Tax Board*, a number of corporations filed
36 returns with Franchise Tax Board in which they claimed
37 deductions for all or part of the dividends that they received from
38 insurance subsidiaries. If the corporations are not entitled to those
39 deductions claimed with respect to such dividends, additional
40 taxes and interest will be due.

1 (4) The Legislature finds and declares that the amendments to
2 Section 24410 of the Revenue and Taxation Code made by this act
3 serve a public purpose and are in furtherance of the public interest
4 in avoiding the unanticipated denial of a deduction with respect to
5 a portion of the dividends paid by insurance companies. Denial of
6 a deduction with respect to those dividends will have a detrimental
7 effect upon the economy of California.

8 (5) The Legislature further finds and declares that the
9 application of the amendments made by this act to taxable years
10 ending on or after December 1, 1997, and commencing before
11 January 1, 2003, serves a public purpose and is in furtherance of
12 legislative intent underlying the enactment of Section 24410 of the
13 Revenue and Taxation Code. The Legislature further finds and
14 declares that the application of the amendments to Section 24410
15 of the Revenue and Taxation Code made by this act promote a
16 public purpose and sound tax policy by affording equitable tax
17 relief to many taxpayers who relied upon the literal language of
18 Section 24410 of the Revenue and Taxation Code in the
19 expectation that they would be entitled to a deduction with respect
20 to a portion of the dividends received from insurance companies.

21 (b) The Legislature further finds and declares all of the
22 following:

23 (1) Section 24425 of the Revenue and Taxation Code denies a
24 deduction with respect to any amount otherwise allowable as a
25 deduction that is allocable to a class of income that is not included
26 in the measure of tax. In general, the Franchise Tax Board
27 maintains that Section 24425 of the Revenue and Taxation Code
28 applies to limit expense deductions associated with insurance
29 company dividends to the extent those dividends are deductible
30 under Section 24410 of the Revenue and Taxation Code. Some
31 taxpayers contend that Section 24425 of the Revenue and Taxation
32 Code does not apply to a deduction arising under Section 24410
33 of the Revenue and Taxation Code under any circumstance.

34 (2) The determination of the amount of an otherwise allowable
35 deduction that is allocable to a class of income that is not included
36 in the measure of tax can be a difficult and subjective judgment and
37 often is not resolved without litigation.

38 (3) Paragraph (3) of subdivision (b) of Section 24410 of the
39 Revenue and Taxation Code that declares Section 24425 of the
40 Revenue and Taxation Code inapplicable to the dividends received

1 deduction for tax years ending on or after December 1, 1997, and
2 commencing before January 1, 2003, represents an integral part of
3 the legislative resolution of the uncertainty created by the Ceridian
4 decision, and is accordingly added by this act in furtherance of the
5 same valid public purposes identified above.

6 (4) For tax years ending prior to December 1, 1997, however,
7 the Ceridian decision has required a full dividends received
8 deduction under Section 24410 of the Revenue and Taxation Code
9 for taxpayers procedurally entitled to assert a claim for refund
10 thereto, and the Franchise Tax Board maintains that Section 24425
11 of the Revenue and Taxation Code applies to limit deductions
12 allocable to these dividends. No inferences should arise from the
13 amendment to subdivision (b) of Section 24410 of the Revenue
14 and Taxation Code by this act with respect to the application of
15 Section 24425 of the Revenue and Taxation Code to deductions
16 allocable to the dividends deductible under Section 24410 of the
17 Revenue and Taxation Code for tax years ending before December
18 1, 1997, or commencing on or after January 1, 2003.

19 (c) The Legislature further declares that the tax treatment of
20 insurance company dividends under Section 24410 of the Revenue
21 and Taxation Code, as amended by this act, is unrelated to and
22 distinguishable from the tax treatment of general corporation
23 dividends under Section 24402 of the Revenue and Taxation Code
24 and from the application of Section 24425 of the Revenue and
25 Taxation Code to deductions allocable to those dividends. The
26 Legislature further finds and declares that no inference with
27 respect to Section 24402 of the Revenue and Taxation Code or the
28 application of Section 24425 of the Revenue and Taxation Code
29 to deductions allocable to those dividends should be drawn from
30 the amendments made to Section 24410 of the Revenue and
31 Taxation Code by this act.

32 SEC. 4. The Franchise Tax Board shall report to the
33 Legislature regarding the amount of tax collected pursuant to the
34 election under subdivision (b) of Section 24410 of the Revenue
35 and Taxation Code by the later of (a) 30 days after the close of the
36 election period or (b) March 15, 2004. If, by the later of (a) 180
37 days from the enactment of this bill or (b) the original filing date
38 of a return for the 2002 taxable year, the amount of tax collected
39 by the Franchise Tax Board is less than \$15 million, then Section
40 24410(a) of the Revenue and Taxation Code, as amended by this

- 1 bill, shall be repealed effective for taxable years beginning on or
- 2 after January 1, 2003.
- 3 SEC. 5. This act provides for a tax levy within the meaning of
- 4 Article IV of the Constitution and shall go into immediate effect.

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